

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0196
Adjusted Gross Income Tax
For the Tax Period 2002**

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ISSUES

I. Adjusted Gross Income Tax –Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-3-2-1, 45 IAC 3.1-1-23(2),

The taxpayers protest the assessment of adjusted gross income tax on unreported gross income.

II. Adjusted Gross Income Tax-Credit for Taxes Paid to other States

Authority: IC 6-3-3-3(a).

The taxpayer protests the lack of credit given them for payment of taxes to other states.

III. Tax Administration-Ten Percent Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

The taxpayers protest the imposition of the penalty.

Statement of Facts

The taxpayers are a married couple. They moved to Texas at the end of June, 2002. As a result, they filed an Indiana partial year resident return for 2002. The Indiana Department of Revenue (department) assessed the taxpayers additional Indiana adjusted gross income tax, interest, and penalty. The taxpayers protested the assessment and a hearing was held. This Letter of Findings results.

I. Adjusted Gross Income Tax-

Discussion

There is no dispute that the taxpayers changed their domicile from Indiana to Texas at the end of June, 2002. The dispute centers on what income is subject to the Indiana adjusted gross income tax. The taxpayers declared their Indiana 2001 adjusted gross income tax refund and capital

gains on assets sold while they lived in Indiana as taxable Indiana income. These amounts totaled \$8,384. The department imposed Indiana adjusted gross income tax on one half of their federally reported \$517,552. The taxpayers protested this assessment.

Indiana Department of Revenue assessments are presumed to be correct. The taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1(b).

Indiana imposes an adjusted gross income tax at IC 6-3-2-1(a) as follows:

Each taxable year, a tax at the rate of three and four-tenths percent (3.4%) of adjusted gross income is imposed . . . on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.

The issue of the Indiana adjusted gross taxability of taxpayers who move from Indiana to another state is discussed at 45 IAC 3.1-1-23(2) as follows:

Any person who, on or before the last day of the taxable year, changes his residence or domicile from Indiana to a place without Indiana, with the intent of abiding permanently without Indiana, is subject to adjusted gross income tax on all taxable income earned while an Indiana resident. Indiana will not tax income of a taxpayer who moves from Indiana and becomes an actual domiciliary of another state or country except that income received from Indiana sources will continue to be taxable.

The taxpayers also protested the imposition of Indiana adjusted gross income tax on wages of \$50,829. The taxpayers provided documentation indicating that those wages were earned by the husband for performance of a job for a corporation when the family lived in Texas. This income was not earned in Indiana and therefore is not from an Indiana source. It is not subject to the Indiana adjusted gross income tax.

The taxpayers also protested the imposition of Indiana adjusted gross income tax on a capital gain of \$2,854. realized upon the sale of stock on December 16, 2002. The Indiana part year resident adjusted gross income tax return instructions deal with which state to report capital gains to on page 9 as follows:

For part-year residents, the portion of the following types of income received while a nonresident would not be reported Indiana income: interest, dividends, royalties and gains from the sale of capital assets, unless such income results from the conduct of a trade or business.

The taxpayers sold the stock and earned the income while they were residents of Texas. Therefore, the gain from the sale of the stock is not subject to the Indiana adjusted gross income tax.

The final point of protest concerns the partnership income of \$444,187 distributed on September 30, 2006. The husband was a partner in a major accounting firm with a September-September fiscal year. During the year the partners are paid a draw. At the end of the firm's fiscal year, the draws are trued up. Each partner is then paid his final distributive share of the partnership

income. If the partner's total draw is less than his total distributive share, the partner receives an additional payment. If the partner's total draw is more than his total distributive share, the partner must reimburse the partnership for the overage paid to him. The taxpayers argued that he did not have final rights to the distributive share and therefore did not earn it until after his move from Indiana to Texas. In essence, the taxpayers argued that the draws were not really income but were more in the nature of nontaxable loans from the partnership to the partners. The taxpayers argued that the total distributive share is taxed at the time it is received like the capital gains on the sale of stock. In this case, that date would be September 30, 2002, after the taxpayers moved to Texas.

The department agrees that the draws are in the nature of loans not subject to income tax at the time they are paid. The department did not, however, impose tax on the draws at the time they were paid. Rather the department imposed tax on the six months worth or 50% of the distributive share that the husband earned when he worked with the accounting firm in Indianapolis. The taxpayer did not just receive the money in Texas like the proceeds from the sale of stock. Rather, the taxpayer received the money as compensation for the efforts he made throughout the fiscal year on behalf of the partnership. Six months of that effort and work during 2002 were from the Indiana office while the taxpayer was a resident of Indiana. This is Indiana source income subject to the Indiana adjusted gross income tax.

Finding

The taxpayers' protest is sustained as to the imposition of Indiana adjusted gross income tax on the wages earned in Texas and gain from the sale of stock while residents of Texas. The taxpayers' protest to the imposition of Indiana adjusted gross income tax on half of the distributive share of the partnership is denied.

II. Adjusted Gross Income Tax-Credit for Taxes Paid to other States

Discussion

The taxpayers argued that should they be found liable for Indiana adjusted gross income tax on a portion of the partnership distribution, he should also receive a credit against the tax for taxes paid in other states.

Indiana law provides for credits against Indiana adjusted gross income tax for taxes paid to another state at IC 6-3-3-3(a) as follows:

Whenever a resident person has become liable for tax to another state upon all or any part of his income for a taxable year derived from sources without this state and subject to taxation under IC 6-3-2, the amount of tax paid by him to the other state shall be credited against the amount of tax payable by him. Such credit shall be allowed upon the production to the department of satisfactory evidence of the fact of such payment except that such application for credit shall not operate to reduce the tax payable under IC 6-3-2 to an amount less than would have been payable were the income from the other state ignored. The credit provided for by this subsection shall not be granted to a taxpayer when the laws of the other state, under which the adjusted gross

income in question is subject to taxation, provides for a credit to the taxpayer substantially similar to that granted by subsection (b).

The statute clearly sets out a credit for taxes paid to another state for no more than the Indiana tax rate. To take this credit, however, the taxpayer must provide the department with evidence that the tax was actually paid to another state.

Finding

The taxpayers' claim to be allowed to take credits against the Indiana adjusted gross income tax for taxes paid to other states is sustained to the extent that the taxpayer can verify the credits for taxes paid with filed tax returns and receipts for payment of taxes to the other states.

III. Tax Administration- Ten Percent (10%) Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

As one spouse is a partner in a major accounting firm, the taxpayers are expected to know and follow the tax laws of the state of Indiana. Their failure to report half of the husband's distributive share of the partnership is a clear situation of failing to use the diligence and reasonable care required of taxpayers. This breach of the taxpayers' duty constitutes negligence.

FINDING

The taxpayer's protest is denied.